No. 175

IN THE

Supreme Court of the United States

ECCO HIGH FREQUENCY CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION AND BRIEF FOR PETITIONER.

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v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION.

To the Honorable Chief Justice and the Associate Justices of the United States:

The petitioner, a corporation organized and existing under the laws of the State of New York, and having its principal office at #7020 Hudson Boulevard, North Bergen, New Jersey, by its attorney Everett Frooks, respectfully seeks a review of a judgment of the Circuit Court of Appeals for the Second Circuit, made on the 27th day of April, 1948, affirming a determination of the Tax Court, dated September 24th, 1947, with respect to alleged tax deficiencies of the petitioner for the tax year 1941.

Jurisdiction.

The petitioner relies upon 28 U. S. C. A. 347 (Judicial Code 240, as amended) as conferring jurisdiction upon this Court to entertain present application.

Not more than three months has elapsed from the date of the judgment of the Circuit Court of Appeals to the date of the judgment of the Circuit Court of Appeals to the date of the making of the application.

Opinions Below.

The opinion of Tax Court appears at page 20, *et seq.*, of the record.

The opinion of the Honorable August N. Hand, Circuit Judge, which is reported in 167 F. 2nd 583, appears at page 94, of the record.

Statement of Matter Involved.

The petitioner, which is a manufacturer of high frequency industrial heating equipment, paid to Emil R. Capita, for services rendered during the tax year in question, the sum of $56,000. The said Capita was the petitioner's only salaried officer and his principal work was in the highly specialized capacity of "sales engineer". Of the amount so paid the Commissioner of Internal Revenue allowed only $25,000 as reasonable compensation for the services in question. The Tax Court allowed $40,000 and the Circuit Court of Appeals has affirmed that allowance. It is the judgment of affirmance by the Circuit Court of Appeals which is sought to be reviewed herein.

The uncontroverted evidence shows that the amount paid for the services rendered which is computed on the basis of a computation of 30% of petitioner's gross sales for the year in question is less than the amount paid by the petitioner's competitors for comparable services, who paid commissions approximating 40% of the gross sales. The Tax Court found that such percentages were a custom of the industry.

The action of the Tax Court in allowing a lesser amount is without foundation in the record.

The Circuit Court of Appeals erred in failing to subject the determination of the Tax Court to a proper review

which would have revealed the fatal defect of foundation for the determination of the Tax Court on the question of reasonable compensation.

Questions Presented.

The petitioner desires to bring up for review by this Court the following questions:

I. Whether the Circuit Court of Appeals has erroneously abdicated its power of review over the Tax Court and thereby deprived the petitioner of substantial rights.

II. Whether Sec. 10 (e) of the Administrative Procedures Act gives the Circuit Court of Appeals a broader power of review than that theretofore existing under the *Dobson* rule and whether in view of such expanded power the Circuit Court of Appeals has in error failed to review the whole record of this case and whether the apparent conflict existing between the Second and Sixth Circuits in this regard should not be clarified.

III. Whether the recent amendment to Sec. 1141 (a) of the Internal Revenue Code entitles petitioner to a broader review by the Circuit Court of Appeals.

IV. Whether these assessments constitute confiscation of petitioner's property.

Reasons for Granting Writ of Certiorari.

It is respectfully submitted that the questions here presented are of substantial general concern. The holding below reveals anew an unwarranted reluctance on the part of the Circuit Court of Appeals to disturb findings of the Tax Court, even though unsupported by substantial evidence.

Statute and Regulations Involved.

Section 23(a) (1) (A) of the Internal Revenue Code provides as follows:

> " (a) Expenses.
>
> " (1) Trade or business expenses.
>
> "(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *"

Regulations 103, Sec. 19.23(a)-6 provide in part as follows:

> "Compensation for Personal Services. — Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:
>
> "(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on

the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

"(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned."

Petitioner's attorney believes that the petitioner has good and meritorious grounds for this application.

WHEREFORE, the petitioner respectfully prays this Court for a Writ of Certiorari to the Circuit Court of Appeals of the United States of the Second Circuit in order to bring up for review thereto the questions herein presented.

EVERETT FROOKS.

IN THE

Supreme Court of the United States

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COMMISSIONER OF INTERNAL REVENUE,
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BRIEF FOR PETITIONER.

ON PETITION FOR WRIT OF CERTIORARI TO CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Opinions Below.

The opinion of Tax Court which is reported in , appears at page 20 et seqq. of the record.

The opinion of the Honorable August N. Hand, Circuit Judge, which is reported in 167 F. 2nd 583, appears at page 94, of the record.

Jurisdiction.

The jurisdiction of this Court is invoked under 28 U. S. C. A. 347 (Judicial Code, Sec. 240, as amended).

Statement of Proceedings.

This case involves a petition to review a judgment of the Circuit Court of Appeals made on April 27, 1948, which judgment affirms an order of the Tax Court heretofore

made herein on September 24, 1946, determining deficiencies against the petitioner for the year 1941, in income tax, declared value excess profits taxes and excess profits tax of $4,237.57, $2,424.18 and $6,309.95, respectively.

Facts.

The issues between the petitioner and the Commissioner, insofar as material to this application, revolve about a payment made by the petitioner to Emil R. Capita, for services rendered during the taxable year in question. The Commissioner originally allowed $25,000 out of a payment of $56,000 made to the said Capita. The Tax Court allowed $40,000 as reasonable and the Circuit Court of Appeals has affirmed that determination.

The said Emil R. Capita was the only salaried officer of the petitioner. His principal work, however, was in the highly specialized capacity of sales engineer. The Tax Court found that it was a trade custom to pay 40% of gross sales as commissions to sales engineers on sales of high frequency equipment in New York City, and slightly more on sales outside that area. The amount paid to Capita was based on a computation of 30% of sales and was subsequently reduced to $56,000.

The Tax Court, in face of its own finding as to the custom, arbitrarily fixes $40,000 as the reasonable value of the services in question.

It was the position of the petitioner in the Court below, that there is not a scintilla of evidence to support the disallowances above referred to.

Summary.

The grounds upon which the petitioner relies for this application may be briefly summarized as follows:

1. That the decision of the Circuit Court of Appeals represents an erroneous extension of the rule in *Dobson* v. *Com'r.* and that accordingly it will be proper for this Court to indicate the true limits of that decision.

2. That question has been raised as to the application of Sec. 10 (e) of the Administrative Procedures Act* which provides that:

> "(e) SCOPE OF REVIEW.—So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) *hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;* (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) *unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute;* or (6) unwarranted by the facts to the extent that the facts are subject to trial *de novo* by the reviewing court. *In making the foregoing determinations the court shall review the whole record of such portions thereof* as may be cited by a party, and due account shall be taken of the rule of prejudicial error." (Italics supplied.)

By reason of the apparent conflict of opinion between the Court below and the decision of the Circuit Court of

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*5 U. S. C. A. 1008 (e).

Appeals of the Sixth Circuit in *Lincoln Electric Co.* v. *Com'r.*, 164 F. 2nd 379, it would be proper for this Court to clarify the applicability of the statute in question.

3. In view of the amendment to Sec. 1141 (a) of the Internal Revenue Code, the Circuit Court of Appeals should be instructed to give effect to its holding in *Kirschenbaum* v. *Com'r.*, 155 F. 2nd, 23.

4. The assessments made herein should be reviewed in the light of possible confiscation of petitioner's property.

POINT I.

That the Court below erroneously limited itself in its review of the determination by the Tax Court so that the Petitioner has in effect been deprived of any real review on the merits.

Since the decision by this Court in *Dobson* v. *Com'r.*, 320 U. S. 488, the multiplicity of factual situations which arise in tax cases has elicited a variety of expression both from this Court and from the Circuit Courts of Appeals as to the exact extent and nature of the power of review possessed by the Circuit Court of Appeals over the determinations of the Tax Court. It would appear that the basis of all the decisions is an effort to give proper weight to the expert opinions of the members of the Tax Court. However, as this Court said in the *Dobson Case:*

> "Its decision of course, must have 'warrant in the record' and reasonable basis in law".

It was the position of the petitioner below as set forth in its brief, in that Court, that in the instant case there is

no "warrant in the record" for the determination of the Tax Court.

It is true that the Court below does not, in so many words, refer to the *Dobson Case,* but, apparently taking an erroneous view of the limitations on its power set by that case, it has completely abdicated its power of review to the detriment of the petitioner.

The Circuit Court of Appeals of the Second Circuit (the Court to which the writ is sought herein), in *Com'r.* v. *Flushingside Realty Co.,* 149 F. 2nd, 572, in its opinion by Judge Learned Hand, accurately delimits the scope of this power of review:

> "So strictly has our review of findings of fact by the Tax Court been confined that it is always with much hesitation that we approach a reversal. Yet *we must have some scrutiny at whatever reserve unless our review is to be limited to a bald examination as to whether the Court has stated enough facts to make a legal foundation for its order.* We should suppose that there might conceivably be constitutional doubts as to such a complete abdication; and up to the present time at any rate, the Supreme Court has not suggested that we must so far abstain. We must assume therefore—the taxpayer having the burden—that if the record is wholly destitute of evidence to support a finding, it is our duty to reverse an order which must rest upon it." (Italics ours.)

It is the contention of the petitioner that the Circuit Court of Appeals has in the present case, entirely ignored this well-considered view of its functions. Petitioner wishes respectfully to call to the attention of this Court that in this case the opinion of the Tax Court and its findings of fact have not, in the language of the quoted opinion, "stated enough facts to make a legal foundation for this

order". All that the Tax Court has to say on the question of its basis for determining the reasonableness of the compensation involved is the single sentence in its opinion (R. 22):

> "it may well be that due to the demand for that particular type of goods no sales effort were required to dispose of all of the equipment produced"

and the Circuit Court of Appeals used this single statement to support its affirmance of the Tax Court; this in face of a record showing uncontroverted evidence that virtually all of Capita's time was spent "in sales engineering" (R. 17, 73, 80, 83) and in face of the express finding of fact by the Tax Court that percentages of gross sales in excess of that paid to Capita were usual and reasonable in the industry involved (R. 18). The very language used indicates that the Tax Court was stating an hypothesis, not finding a fact.

The Court below seems to have lost sight of the essential question because it felt that the petitioner's sales engineer *might have exercised* complete control over the petitioner's assets. After all, it is immaterial whether payments at issue here were made to a person who happens to be a stockholder or not. The corporation might properly pay for services rendered. The fact that Capita might ultimately receive whatever remained, by reason of another legal relationship, has no bearing on the reasonableness of the compensation. Since that is so, if the Circuit Court had reviewed the determination of the Tax Court in the light of the uncontroverted evidence referred to above, the fatal defect in that determination would have clearly appeared. As was said in *Lawton* v. *Com'r.* 164 F 2nd 380, by the Circuit Court of Appeals for the 6th Circuit at page 384:

> "We are aware, of course, that the Tax Court is not required at all event, to believe the testimony of witnesses, or even to accept at face value documents offered in evidence, but it appears to be well settled that the fact finder may not arbitrarily disregard undisputed and uncontradicted testimony of unimpeached persons where he has already found facts which lend a flavor of truthfulness to their assertions."

As we have indicated above, the Tax Court merely stated an hypothesis without foundation in fact, by reason of the multiple relation of Capita to the petitioner. The following language of the Court in the *Lawton* case, *supra,* aptly expresses the petitioner's contention:

> "It is out of such gossamer threads of circumstance the findings and conclusions of the Tax Court are woven, and it becomes our duty to determine whether the findings and conclusions are based upon substantial evidence as the phrase has repeatedly been defined by the Supreme Court."

Thus the Circuit Court, confronted by a maze of facts actually existing and duly found (which, however, are wholly irrelevant to the point at issue) seems to have lost sight of the fact *that there is no substantial evidence to support the principal finding,* i.e., *that Capita's services were reasonably worth $40,000 instead of $56,000.*

It follows from the foregoing that if the petitioner was given the review to which it is entitled under the *Dobson* case, the Circuit Court of Appeals would have been constrained to reverse the determination of the Tax Court, and at very least remand the matter to that Court for further proceedings.

Since the Circuit Court of Appeals has erroneously divested itself of its function of review, this Court should

again enunciate the correct principle and grant the petitioner the relief to which it is entitled.

As this Court said in *Bingham's Trust* v. *Com'r*, 325 U. S. 365:

> "Hence the statute does not leave the Tax Court as the final arbiter of the issue whether its own decisions of questions of law are right or wrong. That can only be ascertained upon resort to the prescribed Appellate process by a consideration of the merits of the point of law involved and by its decision at the conclusion of the process, not before it begins."

POINT II.

That the scope of review possessed by the Circuit Court of Appeals has been enlarged by the Administrative Procedures Act.

Question has been raised as to the exact effect of Sec. 10 (e) of the Administrative Procedures Act upon the reviewability of determinations of the Tax Court. No reference is made in the opinion below to any possible extension of the power of review by that statute, but the Court apparently felt that the power of review was not extended. On the other hand, in *Lincoln Electric Co.* v. *Com'r*, 164 F. 2nd 379, the Circuit Court of Appeals for the Sixth Circuit, gave voice to the opinion that the effect of the statute is to render the determination of the Tax Court subject to a broader review than had been true under the *Dobson* rule. By reason of the diversity of opinion existing among the Circuits it is proper that the decision of the Circuit Court of Appeals in this case be reviewed in the light of applicability of that statute and that this Court give concrete expression to the controlling legal principle.

The Circuit Court should be instructed that it has the power under that statute and that it should exercise that power in this case to set aside the findings and conclusions of the Tax Court as unsupported by substantial evidence and that it should review the whole record and take due account of the rule of prejudicial error.

The petitioner in its brief below argued for the position just stated. In view of the fact that the Circuit Court's opinion is wholly silent on this point, it cannot be said with certainty that account was taken by that Court of the possible effect of the statute and it is respectfully requested that this Court remove the confusion existing.

POINT III.

The amendment to Sec. 1141(a) of the Internal Revenue Code entitles the petitioner to a complete review.

An anomalous situation has heretofore existed in the Second Circuit as a result of the holding of the Court in *Kirschenbaum* v. *Com'r,* 155 F. 2nd 23 (cert. den. 329 U. S. 726), in which the Court held that a determination of the Tax Court as to the effect of a purchase of treasury stock was not reviewable but, at the same time, explicitly reaffirmed a contrary rule for appeals from the District Court.

So, here, there can be no doubt that if the instant case had come to the Circuit Court on appeal from a decision of the District Court, the Circuit Court of Appeals would have had no hesitation in reviewing the record, and free from any artificial restraint must inevitably have seen the want of foundation for the finding of the lower Court.

But the effect of the recently enacted amendment to Sec. 1141 (a) of the Internal Revenue Code is precisely to relieve the Court of that restraint, since it provides that decisions of the Tax Court shall be reviewable to the same extent as decisions of the District Court in non-jury cases.

The effect of this statute is primarily a change in procedure and substantial justice will be effectuated by a direction to the Circuit Court of Appeals to apply the statute to the instant case, and to proceed accordingly.

POINT IV.

The assessments levied in this case are confiscatory and involve an unlawful taking of the Petitioner's property.

As appears from the tables submitted as Appendix "A" hereof, the taxes and assessments, with interest, levied against the petitioner total $47,061.94, or, 119% of the net earnings of the petitioner for the tax year in question; this latter amount was $41,274.25.

As appears from the second table attached, the additional assessments were reduced by the Tax Court from $22,273.30 to $12,971.70. In effecting this reduction it was necessary for the petitioner to make additional expenditures for legal fees. The propriety of such payment is clearly evidenced by the fact that such expenditures resulted in the saving above indicated. When both the saving and the legal fees are taken into consideration, the corporation's expenditures in connection with these taxes total $45,137.08. This amount exceeds 109% of the corporation's net earnings.

While it is quite true that the computation of the net earnings above referred to reflects the $56,000.00 payment

which is sought to be allowed herein, the fact remains that that amount was actually paid in good faith and is not capable of being recouped.

The inevitable result of this process is that the petitioner's capital is being confiscated by the Tax authorities.

The petitioner would like, in addition, respectfully to bring to the attention of this Court, that the delay by the Commissioner in making this assessment (a period of upwards of three years) has resulted in an additional burden of interest. Such delay is perhaps unavoidable, but there is no reason why the petitioner should suffer detriment by reason thereof.

That this Court should review the determination of the Circuit Court of Appeals and remand the proceedings herein for proper review in accordance with law.

Respectfully submitted,

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APPENDIX A.

Actual Figures for 1941—Based on Commissioner's Decision

Gross Sales (1941)		$222,346.65
Less cost of manufacturing and operating expenses and before deducting selling commisions		116,288.08
		$106,058.57
Less Selling Commissions:		
Paid E. R. Capita, Sales Engineer..	$56,000.00	
Paid sales agents	8,784.32	64,784.32
Net earnings for 1941		$ 41,274.25
Federal taxes paid	$20,779.45	
Additional assessments as adjusted by Tax Agent	22,273.30	
Interest on assessments	4,009.19	
Amount demanded by tax collector for 1941 operations	$47,061.94	

Thus, the Tax Collector's assessment is 114% of net income for the taxable year.

Actual Figures for 1941—Based on Tax Court Decision

Gross Sales (1941)		$222,346.65
Less cost of manufacturing and operating expenses and before deducting selling commissions		116,288.08
		$106,058.57
Less Selling Commissions:		
Paid E. R. Capita, Sales Engineer..	$56,000.00	
Paid sales agents	8,784.32	64,784.32
Net earnings for 1941		$ 41,274.25
Federal taxes paid	$20,779.45	
Additional assessments as per tax court ruling	12,971.70	
Interest on assessments to July 22, 1948..	4,907.63	
Legal fees paid up to December 31, 1947 in connection with tax case	6,478.30	
Actual Corporation expenses	$45,137.08	

Thus, $45,137.08 represents the actual Federal taxes, additional assessments, interest thereon and legal fees totalling over 109.6% of the Corporation's net earnings.

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CITATIONS

804186—48

In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 175

ECCO HIGH FREQUENCY CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 15–24)[1] is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 94–98) is reported in 167 F. 2d 583.

[1] The record references are to the Petitioner's Appendix and Proceedings in the Circuit Court of Appeals for the Second Circuit unless otherwise indicated. A duplicate certified copy of the Transcript of Record has been filed with the Clerk of this Court.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 27, 1948 (R. 99). The petition for a writ of certiorari was filed on July 23, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.[2]

QUESTIONS PRESENTED

1. Whether the court below correctly held that there is substantial evidence to support the Tax Court's finding that $40,000, instead of $56,000 claimed by the taxpayer, was a reasonable salary for taxpayer's principal officer under Section 23 (a) of the Internal Revenue Code.

2. Whether the Circuit Court of Appeals properly exercised its power to review decisions of the Tax Court.

STATUTES INVOLVED

The statutes involved will be found in the Appendix, *infra*, pp. 10–12.

STATEMENT

The facts as found by the Tax Court (R. 16–20) are, in pertinent part, substantially as follows:

The business of the taxpayer-corporation is the manufacture of electrical high frequency indus-

[2] Effective September 1, 1948, 28 U. S. C. 1254 (1) becomes the jurisdictional basis for cases of this type. Pub. L. No. 773, 80th Cong., 2d sess.

trial heating equipment (R. 16). Emil R. Capita was its president, treasurer and only salaried officer during the years 1939, 1940 and 1941, and also acted as its sales engineer. Capita had gained knowledge of the business of manufacturing industrial high frequency equipment through his studies and especially through his employment as factory superintendent of the Lepel High Frequency Corporation, a concern engaged in manufacturing a high frequency converter used in automobile motors, by which he was employed between the years 1926 and 1937. In 1937, he decided that it would be advantageous for him to set up a business of his own. (R. 16, 17.) To aid his purpose, his uncle and aunt agreed to furnish capital to organize Ecco High Frequency Corporation, the taxpayer herein. To that end, they each subscribed $2,000 and received 50 shares of its capital stock, and entered into a written agreement with Capita on January 12, 1937, whereby they held the shares issued in their names for his "exclusive use and benefit." They also agreed that they would assign over their shares to Capita at any time upon his repayment to them of the subscription price of the shares; would make no other assignment of their shares except subject to the terms of the foregoing agreement; in the meantime would be entitled to receive all dividends paid on the shares; and that in the event of the liquidation of the corporation

before repayment of the subscription price, they would be entitled to receive $2,000 each while the balance of the liquidating dividends would be payable to Capita. (R. 16). Neither of the stockholders ever took any active part in the conduct of the business (R. 16), and Capita always regarded the business as his own and devoted all of his efforts to making it a success (R. 18). He designed all of the equipment manufactured by taxpayer, purchased all of its materials and sold all of its finished products. Most of the sales resulted from his personal contacts. As sales engineer of the corporation he secured contracts for particular types of equipment, supervised the manufacture, and saw that the equipment was properly installed and capable of satisfactorily functioning. (R. 17.)

It was the custom of the trade to pay commissions of 40% on sales of high frequency heating equipment made within the City of New York and slightly more on sales made outside of that territory (R. 18).[3]

The following table shows the taxpayer's gross sales (less returns and allowances), officers' salaries, net income, federal tax, and dividends paid, for the years 1937–1941, inclusive, as re-

[3] There was also evidence, however, that almost half of this commission was frequently in turn paid by the sales engineer to agents who secured the prospective purchasers, even though the sales engineer closed the sales himself (R. 90).

ported in its income tax returns for the respective years (R. 18):

Year	Gross sales less returns and allowances	Officers' salaries [1]	Net income	Federal tax	Dividends paid
1937	$16,926.75	(a) $3,835.00	$358.09	$51.78	None
1938	21,224.87	(b) 2,467.00	667.89	83.45	None
1939	35,581.19	(c) 7,040.00	849.57	105.20	$240.00
1940	69,489.12	(c) 20,840.00	2,940.15	461.35	240.00
1941	222,346.65	(c) 56,000.00	41,274.25	20,779.45	None

[1] Of the 1937 and 1938 salaries, the amounts of $2,400 and $427, respectively, were paid to Theo Bruning, who served as president of the company until his death in the latter part of 1938. The balance of the salaries for those years, and all of the 1939, 1940 and 1941 salaries were paid to Capita. (R. 18.)

At a meeting of the taxpayer's stockholders held on December 28, 1939, it was agreed that Capita should receive for that year as compensation for his services commissions of 15% of its gross sales. His compensation for 1940 was raised to 30% of gross sales at a stockholders' meeting held December 16, 1940. The same percentage of gross sales, 30%, was voted to him by the directors at a meeting held December 16, 1941, with the provision, however, that his total compensation should not exceed $56,000 for that year. The taxpayer reported this $56,000 in its tax return for 1941 as compensation for officers, but the Commissioner allowed only $25,000 and disallowed the balance, $31,000, as being unreasonable (R. 19). The Tax Court found $40,000 to be a reasonable amount for Capita to receive for his services in 1941 (R. 23–24). The Circuit Court of

Appeals affirmed the decision of the Tax Court (R. 94–98).

ARGUMENT

1. The Tax Court acted well within the power granted it when it found that the amount to be allowed as reasonable compensation was somewhere between the amount claimed by the taxpayer and that allowed by the Commissioner. But it is not the function of an appellate court to make such a determination. The facts set out in the statement, *supra,* and the opinion of the Circuit Court of Appeals (R. 94–98) suffice to show that the ultimate finding of the Tax Court was supported by substantial evidence. We see no justification for further burdening this Court with a discussion of this issue.[4]

2. The taxpayer argues that the scope of review by the Circuit Court of Appeals has been enlarged by the Administrative Procedure Act (Pet. 14–15). If it is assumed *arguendo* that that Act applies to the Tax Court, as the taxpayer urges, the Circuit Court of Appeals was correct in this case, since Section 10 (e) (B) thereof (Appendix, *infra,* p. 12) authorizes the reviewing court to

[4] The petitioner's contention that the tax is confiscatory (Pet. 16–17) is all but frivolous. To reach that result, it deducts legal fees in this proceeding paid up to December 31, 1947, and interest paid to July 22, 1948, in a case involving only the year 1941 (Pet. 18). Moreover, even if the petitioner paid $56,000 to Capita beyond recall, instead of the $40,000 allowable, the Commissioner cannot be estopped by the taxpayer's bad judgment.

reverse the findings and conclusions of an "agency", *inter alia,* when they are unsupported by substantial evidence. And under Section 1141 (c) of the Internal Revenue Code (Appendix, *infra,* p. 11), authorizing a reviewing court to reverse a decision of the Tax Court if it is "not in accordance with law," the "substantial evidence" rule has consistently been employed as the standard for review of factual findings of the Tax Court, both before and since the decision in *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231. See, for example, *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U. S. 37; *Wilmington Co.* v. *Helvering,* 316 U. S. 164; *Commissioner* v. *Scottish American Co.,* 323 U. S. 119; *Boehm* v. *Commissioner,* 326 U. S. 287, rehearing denied, 326 U. S. 811. Thus, the Court of Appeals applied the correct standard of appellate review under both statutes. Cf. *Credit Bureau of Greater N. Y.* v. *Commissioner,* 162 F. 2d 7, 9 (C. C. A. 2d); *Anderson* v. *Commissioner,* 164 F. 2d 870, 874 (C. C. A. 7th). Consequently, in this case there is no necessity for this Court to consider whether the Administrative Procedure Act applies to the Tax Court, as the dictum in *Lincoln Electric Co.* v. *Commissioner,* 162 F. 2d 379, 382 (C. C. A. 6th), suggests (Pet. 14). Indeed, this Court has quite recently denied petitions for certiorari in which arguments identical with that here made were advanced.

Anthony P. Miller, Inc. v. *Commissioner,* 164 F. 2d 268 (C. C. A. 3d), certiorari denied, 333 U. S. 861; *Glenshaw Glass Co.* v. *Commissioner,* decided October 15, 1946 (1946 P-H T. C. Memorandum Decisions, par. 46,245), affirmed *per curiam,* October 21, 1947 (C. C. A. 3d) (1947 C. C. H., par. 9407), certiorari denied, 333 U. S. 842.

3. The taxpayer also argues that the recent amendment of Section 1141 (a) of the Internal Revenue Code (Appendix, *infra,* p. 10) by Section 36 of the Act of June 25, 1948, Pub. L. No. 773, 80th Cong., 2d Sess., broadens the scope of review by the court below in the instant case (Pet. 15–16). Since the effective date of the amendment is September 1, 1948, as provided in Section 38 of the Act, it could not have applied in the instant case. However, even if it were effective, it would not alter the result in this case unless it could be said that the decision of the Tax Court was "clearly erroneous". Rules of Civil Procedure for the District Courts, Rule 52 (a), as amended December 27, 1946. That this is not true is evidenced by the ruling of the court below that the decision of the Tax Court, fixing the reasonable value of Capita's services at $40,000, "cannot be regarded as arbitrary" (R. 97).

CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. The case depends upon its particular facts and is not of general importance. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1948.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * *

(26 U. S. C. 23.)

SEC. 1141. COURTS OF REVIEW.

(a)[1] *Jurisdiction.*—The Circuit Court of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 239 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C. Title 28, Sec. 346); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judi-

[1] This section has been amended by Section 36 of the Act of June 25, 1948, Pub. L. No. 773, 80th Cong., 2d Sess. The effective date of the amendment is September 1, 1948, as provided in Section 38 of the Act of June 25, 1948.

cial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, Sec. 347).

* * * * *

(c) *Powers.*—

(1) *To affirm, modify, or reverse.*—Upon such review, such courts shall have power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court, with or without remanding the case for a rehearing, as justice may require.

* * * * *

(26 U. S. C. 1141.)

Administrative Procedure Act, c. 324, 60 Stat. 237:

DEFINITIONS

SEC. 2. As used in this Act—

(a) *Agency.*—"Agency" means each authority (whether or not written or subject to review by another agency) of the Government of the United States other than Congress, the courts, or the governments of the possessions, Territories, or the District of Columbia. Nothing in this Act shall be construed to repeal delegations of authority as provided by law. * * *

* * * * *

(5 U. S. C. 1001.)

JUDICIAL REVIEW

SEC. 10. Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion—

* * * * *

(e) *Scope of review.*—So far as necessary to decision and where presented the

reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.

(5 U. S. C. 1009).

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